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The Trickle-Down Effect of Intellectual Capital on Banks' Macro Performance in Indonesia

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Abstract

The stock market serves as a representation of economic well-being in a country. Along with the myriad of economic predictors, specific knowledge possession may lead to different macro consequences of stock performance and market value. This study empirically investigates the capacity of possessing excellent intellectual capital to increase the performance and values of listed banks in Indonesia. The selection of banks as the primary data represents such sectors' capability to attract, employ, or exploit the excellent internal capacity under the discussion of resource-based view theory. At best to the authors' knowledge, this topic's findings are still elusive and debatable upon considering the direct and indirect relationships between the proposed exogenous and endogenous variables. Eighteen listed banks form the panel data throughout 2011-2016. This study employs a path analysis and Sobel test to obtain the results of the proposed hypothesis. The results report some positive relationships of the intellectual capital to firms' performances and values, directly and indirectly, with a substantial effect on the second model compared to the first model. This study highlighted knowledge's capacity as a vital basis to gauge the banks' performance and valuation. However, a better formulation of intellectual capital is required to capture a better measurement.

Keywords: Banks, Performance, Firm Value, Intellectual Capital

JEL Classification Code: L25, G21, E22, E24

1. Introduction

The global economy of the last two decades is marked by the emergence of new knowledge-based industries complementing the physical resource-based industries that dominated before (Grant, 1991; Wernerfelt, 1984, 1995). These conditions require every company to face and anticipate all circumstances to pace amid various challenges, especially in securing companies' goals. Companies that implement knowledge-based business will create a way to manage knowledge as a means to obtain company income; by applying knowledgeable-based business, the pursue of firm value will be obtainable (Grant, 1997; Hirdinis, 2019; Pereira & Bonito Filipe, 2018). The Resource-Based Theory approach states that companies can achieve sustainable competitive advantage and obtain maximum profits by owning or controlling strategic assets, both tangible and intangible (Wernerfelt, 1984). Intellectual capital is comprised of the elusive capital of human, structural, and employed best-know-how within firms. The practical and efficient utilization of these three resources creates added value for the company (Grant, 1991; Kantur, 2016; Kogut, 1985; Prahalad & Hamel, 1990). The combination of knowledge possessions leads to the formation of the macrostructure of the stock market in Indonesia's banking sector.

In the management of a knowledge-based system, conventional sources of money, like financial resources and tangible assets, become less critical compared to knowledge-based capital (Meso & Smith, 2000). By using knowledge, procedures on aiming, securing, managing, and defending

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critical resources efficiently and economically can be obtained, allowing the creation of sustainable competitive advantage. However, the source of knowledge in the firms is still debated. Felin and Hesterly (2007) challenged the pursue of a collective form of knowledge resources; and insisting on personal enrichment as a better guide to competitiveness. There is a specific need to incorporate the discussions in a dynamic way of knowledge observation (McInerney, 2002). In achieving excellent performance and market value, stable organizational structures, as well as good relations with customers, are the foundation of intellectual capital (Solikhah et al., 2020).

One of the representations of knowledge management is that intellectual capital forms the best-know-how preparedness to the value of a business entity (Maditinos et al., 2011). The value of an enterprise can be reflected in the price investors pay for their shares on the market (Chen et al., 2005). However, the presence of hidden value emerges as the discrepancies between stock price and the written assets in the book widening put the researchers to be interested in investigating hidden values in financial statements. Human and knowledge capitals form a specific resource-based competitive edges in the market (Grant, 1991). A successful company is a company that sees and treats the ability to think and be knowledgeable as the principal capital in carrying out its business activities. Therefore, business organizations increasingly emphasize the intangible aspect of resources like knowledge and disclose them to secure public acceptance (Li et al., 2008). The insufficiency of financial statements to explain firm value indicate that economic resources are not only physical assets but also the creation of intellectual capital (Rahman et al., 2020). While several studies have investigated these issues, the exploration of the banking sector is still inadequate. This study aims to contribute the findings by investigating the capacity of banks' intellectual capital to generate financial performance, and subsequently, the banks' value in a direct and indirect relationship.

2. Literature Review

2.1. Firm Value

The value of business entities is the sums that prospective buyers consider if the company is sold. The stocks in the market reflect the share price of a firm. The higher the security valuation is, the more precious a firm is. The company market value is the amount or scale of the share price that investors want to pay. Thus, with the increase in share price, indeed, a shareholder will become more abundant and more prosperous. A company has good value if the reported performance is also catching-up, and firm value is reflected from many facets, even the marketing performance (Frennea et al., 2019; Liu et al., 2017).

This study measures the firm value by finding the price-book value (PBV) of each bank (Fang et al., 2009). A high price-book value will make the market believe in the company's prospects going forward. PBV is a comparison between market prices and book values. A PBV above one indicates that the share market value is higher than the book value suggesting a perceived running-well company. The more excellent PBV ratio reveals a higher value than the invested funds in the companies, pointing to a more significant potential ahead (Green & Jame, 2013). PBV describes the market's appreciation of the book value of an enterprise's shares. Market appreciation is a form of public trust in the company and can describe the company's condition in the future. The up and down of enterprise value is influenced by the enterprise's ability to create value as the PBV suggests. At the same time, the book value contains information about the wealth, liabilities in the historical records of the balance sheet (Clarkson et al., 2011).

2.2. Intellectual Capital

The International Federation of Accountants (IFAC) defines intellectual capital as the strategic ownership of intellectual competitiveness, assets, and knowledge within firms (Garanina, 2009). On the other hand, Stewart defines intellectual capital as the mutually understood capacity supported by everyone in the company as the competitive advantage; furthermore, it includes the possession of intellectuality in the form of experience, information, intellectual rights or specific knowledge that potentially can generate further wealth (Stewart & Ruckdeschel, 1998). At the same time, Firer and Williams define intellectual capital as work-embedded information and knowledge to secure positive value competitiveness (Firer & Mitchell Williams, 2003). This study employs the VAIC method by Pulic to calculate the intellectual capital from the possessed physical and non-physical assets (Firer & Mitchell Williams, 2003; Nahapiet & Ghoshal, 2009; Pulic, 2000). This suggests that good governance of intellectual resources is a strategic advantage that will boost company efficiency. The contribution to financial results as an influence of the application of intellectual capital plays an important role in the growth of banking (Gotama & Indarwati, 2019). The higher the company's output, the greater the company's ability to produce net profits from year to year which will result in an improvement in the company's business. Shareholders would admire businesses that are able to generate value by optimizing the use of intellectual capital elements.

The presence of excellent audit quality could increase the disclosure of that important tacit knowledge (Astuti et al., 2020). By generating good value, the organization would be

better positioned to represent the needs of all stakeholders. Capital market companies will show appreciation for the benefits of intellectual capital owned by companies by investing in these companies. In this study, investors tend to use the rationality concept of accounting information when assessing a company. Accounting information is information on the company's financial statements, which includes data on reports and prospectuses, valuation of shares by calculation of NPV, IRR and other ratios. This leads to accounting information, namely the financial performance of the company or the financial statements of the company. The increase in the intellectual capital output value of Indonesian banks indicates that Indonesian banks are beginning to pay attention to their intellectual assets. Intangible asset management is important to render and reveal to the public, given that there are variations in market value and company value, such that information presented by financial reporting is no longer valid due to hidden value. In Indonesia, therefore, intellectual capital reporting is still voluntary and the disclosure of intellectual capital is used as a strategy to win tighter business competition.

2.3. Financial Performance

Financial performance is a company's work performance in the financial sector (Suriyanti, 2020). It can also be interpreted as an achievement that has been manifested through the work that has been done and has been put in the financial statements as well as can be used as a benchmark to determine the level of success of the company in a certain period. Financial performance means the company's financial condition in a specific period that is different from the previous condition, where this performance is measured by financial ratios consisting of liquidity, solvency, profitability, activity, and market. Besides, the company's financial performance is a desired and required achievement for each specific timeframe reflecting the health of the company (Usman & Lestari, 2019). This research proxy the performance from the information of return on equity ratio (ROE), because it represents the companies' ability to secure investment opportunities and effective cost management (Fama & French, 1992, 2002; Martin, 2017). The impact of financial performance is that it can increase the value of the company. This could be an ambition for stakeholders to perform financial performance engineering, or the term revenue management in finance. With the aim of encouraging shareholders to invest in increasingly fierce competition. However, Islam is a comprehensive religion, in true Islam, there are rules that govern it when it comes to doing something. Therefore, in order to assess the correct financial performance of a corporation, the financial statements must be prepared in compliance with the laws or regulations without manipulation.

3. Research Methods and Materials

This study obtains the data from the listed banks in the Indonesia Stock Exchange period 2011-2016 using purposive sampling. Based on the sample selection process, 18 companies were obtained per observation period, forming a panel data for the investigation. Thus, the total number of samples obtained was 18 x 6 = 108 times of observations or samples. The data needed in this study was in the form of financial statements, and company profiles, as well as other needed data of each company selected as a sample in the 2011-2016 timeframe available at the Pusat Informasi Pasar Modal (PIPM/Capital Market Information Center), accessed through www.idx.co.id, as well as the webpage of the sampled company.

This study provided the descriptive data of the investigated variables in table 1 representing the computed VAIC, ROE, and PBV. Also, inferential statistics were used. This study constructed a path analysis to probe the interacting relationships in the direct and indirect effects of the model. The proposed conceptual framework is:

The data to be processed must first be free from the classic assumption test. This study further employs the Sobel test to obtain the mediating relationships among the direct and indirect variables. There are five formulas to obtain the VAIC as follows (see Table 1):

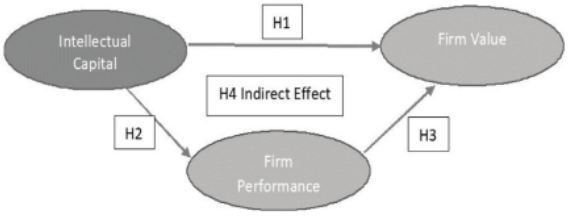

Figure 1: Conceptual Framework

Table 1: The Steps to obtain VAIC

Steps	Information	Equation
1	Find the firms' value-added	Output-input (1)
2	Find each secured value for a given capital	Value-added/ employed capital (2)
3	Calculate the obtained value for each secured human capabilities	Value-added/ human capital (3)
4	Compute each secured structural capital from the secured value	Structural capital/value-added (4)
5	VAIC	Sums step 2-4

Source: Pulic (2000)

Where: - Output = Total realizable sales and income
- Input = All used expenses to produce sales (employee costs aside).
- CE = the employed capital: (equity, profit).
- HC = the capital of employees: Salary and employee benefits
- SC = the structural capital: value-added – human capital

The use of VAIC calculation may provide a proxy to the calculation of the intellectual capital from public information like audited financial reports (Iazzolino & Laise, 2013; Pulic, 2000).

4. Results and Discussion

Table 2 compiles the descriptive tests of the study. It can be seen that the average VAIC index is 1.2821, with a deviation value of 0.37634. The lowest score of intellectual capital is 0.29. In comparison, the maximum value of VAIC is 2.32, which indicates that the use of IC can provide a maximum added value of 2.32 during the 2011-2016 period. The minimum value resulting from the use of equity during this period is 0.70, while the most significant contribution to the use of equity reaches a value of 42.49. It is known that the average value of an enterprise that is proxied using PBV is 1.7683, with a standard deviation of 1.09626. The lowest value of PBV is 0.35, while the highest firm value during the observation period can contribute as much as 5.70.

It is known that in the results of model 1, the adjusted R square value is 0.260. In contrast, the remaining 0.74 or 74% is beyond this study investigation. Table 3 reveals an F-value of 38.680 with a probability (significance) of 0.000, concluding the significant effect of the investigated variable in the first model. Thus, the first hypothesis in this research is accepted (H1 accepted).

This research also reported the adjusted R square value of 0.528. In comparison, the remaining 0.472 or 47.2% presents the possible confounding effect aside from this paper found. The F-value of 60.869 provides support for the use of the second model in the study. Regression model 2 also shows a connection between VAIC and PBV. The statistical analysis reveals the t-value of 2.672, higher than the 1.96 cut-off measurements for 5% error coefficients. They are obtaining a significance value of 0.009<0.05, proving VAIC realizable effect on the enterprise value as proxied by PBV. At the same time, testing of the third hypothesis regarding the effect of financial performance variables (ROE) on enterprise value (PBV) shows the t value of 7.781 with a significance value of 0.000<0.05, confirming hypothesis H2 and H3.

A Sobel test is also performed to investigate the potential mediation relationship. The result of the calculation is as follows:

$$\begin{aligned} Sab &= \sqrt{(b^2 SEa^2) + (a^2 SEb^2)} \\ &= \sqrt{\left(0.081^2.1.812^2\right) + \left(11.270^2.0.010^2\right)} \\ &= \sqrt{0.02154202 + 0.1270129} \\ &= \sqrt{0.14855492} \\ &= 0.3854282294 \end{aligned} \quad (1)$$

After obtaining the value of Sab, then to find out the t value of the mediation effect is as follows:

$$\begin{aligned} t &= \frac{ab}{Sab} \\ &= \frac{11.270 \times 0.081}{0.3854282294} \\ &= 2.3684 \end{aligned} \quad (2)$$

Table 2: Descriptive measures

Variable	N	Minimum	Maximum	Mean	Std. Deviation
VAIC_LN	108	0.29	2.32	1.2821	.37634
ROE	108	0.70	42.49	15.9742	8.20264
PBV	108	0.35	5.70	1.7683	1.09626
Valid N	108				

Table 3: The Summary of the Path Analysis

Tests	Variables	R^2	F-value	t-value	p-values	Hypothesis
1st model	VAIC → ROE	0,260	38.680	6,219	0,000	H1 accepted
2nd model	VAIC → PBV	0.528	60,869	2.672	0.009	H2 rejected
	ROE → PBV			7.781	0.000	H3 accepted

The results of the Sobel test show a t-value of 2.3684. This value is higher than the t table with a significance level of 0.05 as much as 1.663 so that the intervening variable (financial performance) mediates the intellectual capital to firm value. The indirect relationship between each variable is computed by multiplying the coefficients $\beta 1 \times \beta 3 = 0.517$ x 0.604 = 0.312. While the total effect = direct effect + indirect effect = 0.207 + 0.312 = 0.519. The results prove the larger size of indirect effect compared to the intellectual capital direct relationship on firm value. This finding supported the hypothesis 4. Further conversation on the findings is in the next section.

The efficient and effective intellectual capital utilization shall add the strategic competitive advantages in the context of resource management within firms/banks, leading to financial performance (Grant, 1997; Teece, 2007; Teece et al., 1997). The findings of this research are also consistent with the previous researches (Hitt et al., 2001; Lo & Leow, 2014), adhering to the substantial positive contribution of IC (VAIC) on the performance of firms as proxied by ROA. This finding provided evidence to the ability of Indonesia banks to manage their knowledge asset and exploit it to achieve a better competitive position (Kuratko & Audretsch, 2009). IC has played an essential role in shaping value-added and has contributed to improving companies' financial performance in Indonesia (Nuryaman, 2015). Moreover, a company can increase its competitive advantage if it can manage its knowledge assets well, so that intellectual capital will contribute to improving the company's financial performance (Crook et al., 2011; Wang et al., 2014).

This study discovered that the value of the firms was subject to intellectual capital management (Nahapiet & Ghoshal, 2009). Thus, the higher the investor values the share price of an enterprise, the higher the enterprise valuation is. The results of this study are consistent previous study that firms must secure the critical position in the competition as represented by its specific knowledge and exploit it as the means to expand firm valuation (Ha & Nguyen, 2020; Loke et al., 2020; Pulic, 2000). The creation of wealth (Stewart & Ruckdeschel, 1998) from these activities implies that banks value their resource administration effectively. With sufficient knowledge management, the values in social life, organization especially in the company, will increase. In general, the results of testing hypothesis two (H2) are relatively similar to the findings of Chen et al. With more detailed testing, Chen found that the VACA and VAHU indicators affect enterprise value (Chen et al., 2005). In line with (Maditinos et al., 2011), they found the positive relationship of IC on the value of firms.

As proxied by the ROE, the emerging financial performance reveals the banks' capacity to utilize their equity or capital in generating profits (Aebi et al., 2012). The results are consistent with the following investigations by (Crisóstomo et al., 2011; Harrison & Wicks, 2013; McConaughy et al., 2001), who supported the substantial contribution of financial performance in generating positive enterprise value. Seeing the impact of financial performance can increase enterprise value. This could be an ambition for stakeholders to engineer financial performance, or the term in finance is earnings management intending to lure shareholders into investing amid increasingly fierce competition (Harrison & Wicks, 2013; Phillips et al., 2017).

The Sobel test also strengthens the significant finding of indirect relationships. This test states that financial performance can mediate indirectly (indirect effect 0.312>0.207 direct effects). This study's findings are consistently in line with the pieces of evidence of (Bollen et al., 2005; Chen et al., 2005; Clarke et al., 2011; Nuryaman, 2015; Wang et al., 2014), who stated that financial performance could mediate intellectual capital with enterprise value. These supporting thoughts indicate that excellent management of intellectual capital contributes positively to the competitive advantage and is reflected in the performance of the banks. The successful exploitation of the possessed intellectual capital serves as the vital basis of bank development. The capacity of banks to manage its entrusted funds from the investors and customers has to come under the management of specific knowledge to satisfy the shareholders, as this study proofed (Harrison & Wicks, 2013). The increasing value of the intellectual capital performance of Indonesian banking shows that Indonesian banking is starting to pay attention to its intellectual assets (Amar et al., 2019).

This suggests that good governance of intellectual resources is a strategic advantage that will boost company efficiency. The contribution to financial results as an influence of the application of intellectual capital plays an important role in the growth of banking. The higher the company's output, the greater the company's ability to produce net profits from year to year which will result in an improvement in the company's business. Shareholders would admire businesses that are able to generate value by optimizing the use of intellectual capital elements. By generating good value, the organization would be better positioned to represent the needs of all stakeholders by exploiting the media capability (Abdullah et al., 2020). The increase in the intellectual capital output value of Indonesian banks indicates that Indonesian banks are beginning to pay attention to their intellectual assets. Intangible asset management is important to render and reveal to the public, given that there are variations in market value and company value, such that information presented by financial reporting is no longer valid due to hidden value. Management of these intangible assets is essential to be done and disclosed to the public, given that there are differences in market values with enterprise values, so the information provided through financial statements becomes irrelevant because of hidden values.

5. Conclusion

This research empirically proves the effect of intellectual capital to generate a positive value of publicly-listed banks as mediated by the financial performance for 2011-2016 in Indonesia. The correct utilization and management of intellectual capital are going to support the development of firm productivity and subsequently followed by improving financial performance. The second hypothesis can be accepted that intellectual capital (VAIC) affects enterprise value (PBV). This finding supported the idea that the market appreciation of a company is not only from the physical assets but also from the intellectual capital position in the market competition. This study also supported the notion that financial performance (ROE) constitutes a positive image for the valuation of the banks. This indicates that increasing the financial performance of an enterprise will cause the enterprise value to increase. The fourth hypothesis (H4) testing shows that financial performance mediates the relationship between each investigated variable, as confirmed in the Sobel test. This article tries to contribute to the field of economic research, focusing on the issue of knowledge as a predictor of banking performance and value. This research requires more extensive time-series data collection, so the research results are more convincing, as well as the discussion that needs to provide the latest managerial issues. Future researches can enrich the writing on this topic by considering the number of samples and also the depth of discussion and references.

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